



JAMES L. McINTIRE
State Treasurer

State of Washington
Office of the Treasurer
Local Government Investment

October 30, 2012

The Honorable Christine O. Gregoire, Governor
The Honorable Brian Sonntag, State Auditor
Members of the State Finance Committee
Members of the Joint Legislative Audit and Review Committee
Participants in the Local Government Investment Pool

I am pleased to submit this Comprehensive Annual Financial Report (CAFR) of the state of Washington Local Government Investment Pool (LGIP) for the fiscal year ended June 30, 2012. This report has been prepared by the Office of the State Treasurer (OST) pursuant to Revised Code of Washington (RCW) 43.250.080. It includes only activity of the LGIP and does not include data or information related to other state agencies or funds.

Responsibility for the accuracy of the data, as well as the completeness and fairness of the presentation, including all disclosures, rests with management of the OST. Management is responsible for establishing and maintaining internal controls designed to ensure the assets of the LGIP are protected from loss, theft, or misuse, and that the preparation of financial statements is in conformance with generally accepted accounting principles. Internal controls are designed to provide reasonable, but not absolute, assurance that these objectives are met. The concept of reasonable assurance recognizes that the cost of controls should not exceed the benefits likely to be derived, and the evaluation of costs and benefits requires estimates and judgments by management. To the best of our knowledge, the enclosed data are accurate in all material respects and are reported in a manner designed to present fairly the financial position and results of operations of the LGIP.

The LGIP's financial statements have been audited by Peterson Sullivan LLP. The independent auditor rendered an unqualified ("clean") opinion on the financial statements for the fiscal year ended June 30, 2012. The independent auditors' report is included in the financial section of this report.

Management's Discussion and Analysis (MD&A), immediately following the independent auditors' report, provides a narrative introduction, overview and analysis of the basic financial statements. The MD&A complements this letter and should be read in conjunction with it.

Profile of the LGIP

The LGIP, created by the Washington State Legislature in 1986, is managed and operated solely by OST. The State Finance Committee administers the statute that created the pool and adopts appropriate rules. The State Treasurer established the LGIP Advisory Committee to provide advice on the pool's operation. The advisory committee includes 12 members selected from active pool participants. Eight members are appointed by participant associations, and four are appointed by the State Treasurer.

The LGIP is operated as a business enterprise within the framework of state laws and regulations. The LGIP's primary purpose is to provide an investment tool for eligible governmental entities. At their option, such entities may invest temporary cash surpluses to take advantage of the volume and expertise of the state's investment program to earn a competitive rate of return while maintaining security and

liquidity. The objectives of the State Treasurer's investment program, in priority order, are safety, liquidity and return on investment.

Investment Risk Profile

The LGIP is considered extremely low risk. Its funds are invested in a portfolio of securities in a manner generally consistent with the Securities and Exchange Commission's Rule 2a-7 of the Investment Company Act of 1940 as it currently stands. Rule 2a-7 funds are limited to high quality obligations with limited maximum and average maturities, the effect of which is to minimize both market and credit risk. The portfolio is made up of high-quality, highly liquid securities, and its relatively short average maturity reduces the pool's price sensitivity to market interest rate fluctuations. The LGIP also has a strong degree of asset diversification to minimize risk and maintain adequate rates of return.

The investment activity is guided by an investment policy, approved by the State Treasurer and operates under the standard of the prudent investor. OST operates the LGIP for investing cash in excess of daily requirements. Among the investments authorized by statute are: U.S. Treasury and agency securities, banker's acceptances, repurchase agreements, reverse repurchase agreements, commercial paper, and deposits with qualified public depositories.

The LGIP is managed diligently by professional treasury personnel to protect against losses from market and credit changes. However, the pool is not insured or guaranteed by any government. Therefore, the maintenance of principal is not fully assured.

Economic Condition and Outlook

The economic condition of the LGIP is based primarily upon investment earnings. Due to the short-term nature of the LGIP portfolio, and the types of investments utilized, the LGIP yields closely follow the targeted federal funds rate. With \$8.8 billion in net assets as of June 30, 2012, the LGIP produced an average monthly portfolio yield of .14 percent. The LGIP exceeded its benchmark by 13 basis points, resulting in \$12 million in additional interest income for participants.

Fiscal year 2012 was marked by sustained monetary policy by the Federal Open Market Committee (FOMC). The FOMC did not change its target for the federal funds rate from July 2011 through June 2012 stating that economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations called for extremely low rate levels. The targeted federal funds rate began and ended the fiscal year at 0 to 1/4 percent.

During the period, the FOMC remarked that the economy has been expanding moderately; labor market conditions have improved; the unemployment rate has declined but remains elevated; household spending appears to be rising at a slow pace; business fixed investment has continued to advance; and, despite some signs of improvement, the housing sector continued to be depressed. Furthermore, strains in global financial markets continue to pose significant downside risks to the economic outlook.

Consistent with its statutory mandate, the FOMC employed its policy tools to foster maximum employment and price stability. To support a stronger economic recovery and help ensure that inflation is at the rate most consistent with its mandate, the FOMC expects to maintain a highly accommodative stance for monetary policy. The FOMC is closely monitoring economic and financial developments, and providing accommodations as needed to promote recovery and sustained improvement in labor market conditions in the context of price stability.

During the first quarter of fiscal year 2013, the FOMC has maintained its target range for the federal funds rate at 0 to 1/4 percent anticipating that economic conditions are likely to warrant exceptionally low levels for the federal funds rate at least through mid-2015.

Major Initiatives

OST is planning to begin calculating earnings and expenses for LGIP participants daily rather than monthly in early 2013. The daily expense factor would be based on estimated annual expenses adjusted throughout the fiscal year for changes in those estimates. The daily earnings factor would reflect accrued and accreted income less expenses. Earnings would continue to be credited to participant accounts monthly while capital gains or losses would be distributed periodically.

OST is also exploring the feasibility of offering a longer-term investment fund option to LGIP participants, similar to an intermediate bond fund, to complement the current 2a-7 like money market fund option. PFM Asset Management has been retained to provide oversight and guidance for the development and launch of this extended asset fund, as well as, assist in the education and outreach to LGIP participants. Upon completion of a prospectus and administrative rules, OST expects to begin operation in mid-2013.

Additional Information

A section of the State Treasurer's website is dedicated to the LGIP. This CAFR, plus additional information for participants and interested parties, may be accessed through the OST website (<http://www.tre.wa.gov/>).

Awards

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the LGIP for its Comprehensive Annual Financial Report for the fiscal year ended June 30, 2011. This was the fifteenth consecutive year the LGIP achieved this prestigious award. To be awarded a Certificate of Achievement, OST had to publish an easily readable and efficiently organized CAFR that satisfied both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. OST believes this CAFR continues to meet the Certificate of Achievement Program's requirements and will submit it to the GFOA to determine its eligibility for another certificate.

Acknowledgments

The preparation of this report was accomplished with the professionalism and dedicated services of personnel in OST's Accounting and Fiscal Services Division and its Investment Division. This CAFR reflects the State Treasurer's commitment to pool participants and citizens of the state of Washington to operate the LGIP in a responsible manner and to maintain financial statements in conformance with the highest standards of financial accountability.

Sincerely,



Shad Pruitt
Deputy State Treasurer